

In general, the Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily (over 50%) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Adm. Code 130.330. (This is a GIL).

May 7, 1999

Dear Xxxxx:

This letter is in response to your letter dated March 25, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

Our company is dealing with

- machinery for glass processing, i.e. glass cutting and insulating glass production
- parts
- software (customized)

Most of our equipment is used in direct manufacturing process, to produce insulating glass elements used e.g. for windows.

Our only physical location of business is in STATE, but we are selling also to Alabama.

We are selling our equipment either

- by having our sales person visit the customers
- via the phone, by receiving written orders ...

We are shipping by using freight carriers or express services, we do not have own transport facilities.

We now have the following questions:

- Are we taxable on selling our equipment to your state?
- Can we obtain a manufacturing exemption certificate?
- If our sale is taxable, what is the tax rate and procedure?

Our customers, who produce and sell windows, can be either retailer or contractor.

- Is this sale taxable
  - within the state of Alabama
  - out of the state?

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- If yes, what is the tax rate and procedure?
- Can they obtain a resale exemption certificate?

We kindly ask you to provide us with your written statement on our questions and appreciate your soon reply. In case of need for further clarification please call me at #####.

Although your letter does not indicate that you are making sales in Illinois, we are assuming that you do for the purposes of our response. The Retailers' Occupation Tax Act imposes a tax on persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption and is measured by the seller's gross receipts from sales made in the course of such business. See the enclosed copy of 86 Ill. Adm. Code 130.101. "Gross receipts," means all of the consideration actually received by the seller, except traded-in tangible personal property. See the enclosed copy of 86 Ill. Adm. Code 130.401. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3 (1996 State Bar Edition).

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A

retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax.

A license of software is not a taxable retail sale if:

- A) it is evidenced by a written agreement signed by the licensor and the customer;
- B) it restricts the customer's duplication and use of the software;
- C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);
- D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) the customer must destroy or return all copies of the software to the vendor at the end of the license period.

As stated above, licenses of computer software are not taxable if they meet all of the criteria listed in Section 130.1935(a)(1). However, item (D) of that part requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed software license agreements to have met this criteria if the agreements do not contain a provision about the loss or damage of the software, but the vendors' records reflect that they have a policy of providing copies of software at minimal or no cost if the customers lose or destroy the software.

Item (E) of this part also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the

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license period. The Department has also deemed perpetual license agreements to qualify for this criteria even though no provision is included in the agreements that requires the return or the destruction of the software.

Enclosed is a copy of 86 Ill. Adm. Code 130.330 concerning the Manufacturing Machinery and Equipment Exemption. In general, the Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily (over 50%) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease.

When determining whether a piece of equipment qualifies for the manufacturing machinery and equipment exemption, the requirements of 86 Ill. Adm. Code 130.330 must be met. "Manufacturing", as defined in this regulation, is the production of articles of tangible personal property, whether such articles are finished products or articles for use in the process of manufacturing or assembling different articles of tangible personal property by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant, Section 130.330(b)(2).

Illinois retailers making sales for use or consumption, and not for resale, incur Retailers' Occupation Tax on such sales and must collect the corresponding Use Tax from customers or document an exemption. Exemption certificates shall be executed by purchasers and submitted to retailers. Form ST-587, Machinery and Equipment Exemption Certificate, may be used to document the manufacturing machinery and equipment exemption. If the user has an active registration or resale number, that number may be given in lieu of the prescribed certificate. See Section 130.330(g).

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk  
Enc.